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# In the Supreme Court of the United States

**COMMISSIONER OF INTERNAL REVENUE,**

*Petitioner,*

v.

**JOHN W. BANKS, II,**

*Respondent.*

**On Petition for a Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit**

## BRIEF FOR THE RESPONDENT IN OPPOSITION

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## QUESTION PRESENTED

Whether the court of appeals below correctly determined that the anticipatory assignment of income doctrine does not require an employment discrimination plaintiff to include in his or her gross income the portion of a settlement or judgment paid to his or her attorney under a contingent fee agreement.

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## BRIEF FOR THE RESPONDENT IN OPPOSITION

## OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a–33a) is reported at 345 F.3d 373. The opinion of the Tax Court (Pet. App. 34a-57a) is a memorandum decision, T.C. Memo. 2001-48 (Feb. 28, 2001), unofficially reported at 81 T.C.M. (CCH) 1219.

## JURISDICTION

The judgment of the court of appeals was filed on September 30, 2003. The petition for certiorari was filed on December 19, 2003. This Court has jurisdiction under 28 U.S.C. § 1254(1).

## STATEMENT

1. Respondent John W. Banks, II, filed a federal civil rights employment discrimination lawsuit against his former employer, the California Department of Education, in 1984. Mr. Banks filed two amended complaints, and a second lawsuit. The two lawsuits were consolidated. Shortly after trial began in 1990, Mr. Banks settled all of his claims for $464,000. Pursuant to a contingent fee contract Mr. Banks entered into with his attorney before the commencement of the lawsuit, $150,000 of the settlement amount was paid by the defendant to Mr. Banks's attorney. Pet. App. 1a-5a.

2. In 1997, the Commissioner issued a Notice of Deficiency to Mr. Banks for the 1990 tax year. Pursuant to the Notice, the portion of the settlement proceeds paid to Mr. Banks's attorney under the contingent fee agreement constituted taxable income to Mr. Banks. Mr. Banks filed a timely petition with the United States Tax Court challenging the Commissioner's determination. Pet. App. 6a.

3. The Tax Court upheld the Commissioner's determination that the portion of the settlement in Mr. Banks's discrimination lawsuit paid to Mr. Banks's attorney as a contingent fee constituted taxable income to Mr. Banks. Pet. App. 52a.

4. Mr. Banks appealed the Tax Court's decision. Expressly relying on its previous decision in *Estate of Clarks v. Commissioner*, 202 F.3d 854 (6th Cir. 2000), the court of appeals below reversed the Tax Court. In *Estate of Clarks*, the court of appeals held that the taxpayer in that case was not required to include in his or her gross income the attorney's contingent fee portion of a recovery: "The income should be charged to the one who earned it and received it [i.e., the attorney], not as under the government's theory of the case, to one who neither received it nor earned it [i.e., the taxpayer-client]." 202 F.3d at 858. Consistent with its prior precedent in *Estate of Clarks*, the court of appeals held that the portion of the settlement paid to Mr. Banks's attorney as a contingent fee was not income to Mr. Banks. Pet. App. 25a.

## ARGUMENT

1. The Commissioner has consistently opposed, and this Court has routinely denied, a grant of certiorari on the precise federal income tax issue on which the Commissioner now seeks certiorari. *Sinyard v. Commissioner*, 268 F.3d 756 (9th Cir. 2001), *cert. denied*, No. 01-1380, 536 U.S. 904 (2002) (Commissioner's brief in opposition available at 2002 WL 32135079); *Hukkanen-Campbell v. Commissioner*, 247 F.3d 1312 (10th Cir. 2001), *cert. denied*, No. 01-1348, 535 U.S. 1056 (2002)[1]; *Coady v. Commissioner*, 213 F.3d 1187 (9th Cir. 2000), *cert. denied*, No. 00-1326, 532 U.S. 972 (2001)

[1] The Commissioner's brief in opposition is available at <http://www.usdoj.gov/osg/briefs/2001/0responses/2001-1348.resp.html>.



(Commissioner's brief in opposition available at 2000 WL 34000205); *Benci-Woodward v. Commissioner*, 219 F.3d 941 (9th Cir. 2000), *cert. denied*, No. 00-592, 531 U.S. 1112 (2001) (Commissioner's brief in opposition available at 2000 WL 34000856).

Far from "exacerbat[ing]" (Pet. 3) any perceived conflict among the circuits, the decision of the court of appeals below is in accord with other decisions in existence at the time when the Commissioner had previously been opposing certiorari on this issue with great vigor. The court of appeals below carefully explained that it was adopting the approach it had previously taken in *Estate of Clarks*, *supra*, and that the Fifth Circuit had taken in *Srivastava v. Commissioner*, 220 F.3d 353 (5th Cir. 2000). In those cases, the state attorney lien laws governing the taxpayers' relationships with their attorneys were considered in conjunction with other factors. The court of appeals below explained:

> [T]he reasoning in *Estate of Clarks* case seems to have been based on more than the nature of Michigan's lien law. To be sure, the similarity between Michigan's attorney's lien statute in *Estate of Clarks* and Alabama's attorney's lien statute in *Cotnam* [*v. Commissioner*, 263 F.2d 119 (5th Cir. 1959)] played a role in the outcome. *Estate of Clarks*, 202 F.3d at 856. However, we found other factors persuasive in distinguishing contingency fees from *Lucas* [*v. Earl*, 281 U.S. 111 (1930)] and [Helvering v.] *Horst*, [311 U.S. 112 (1940)] including the following: (1) the fact that the claim, at the time the contingency fee agreement was signed, was "an intangible, contingent expectancy," (2) taxpayer's claim was like a partnership or joint venture in which the taxpayer assigned away one-third in hope of recovering two-thirds; (3) no tax-avoidance purpose was at work with the contingency fee arrangement, as there ostensibly was in *Lucas* and *Horst*; and (4) double taxation would

otherwise result by including the contingency fee in taxpayer's income. *Id.* at 857-58.

Pet. App. 24a. *See also* Pet. App. 23a ("We find persuasive the reasoning of the Fifth Circuit, which recently faced similar factual circumstances") (citing *Srivastava*); and Pet. App. 25a (holding that "*Estate of Clarks* is controlling in the present case").

*Estate of Clarks* and *Srivastava* were already decided—and published in the Federal Reporter, Third Series—when the Commissioner, in opposing certiorari in *Sinyard*, *Coady*, *Hukkanen-Campbell*, and *Benci-Woodward*, represented to this Court, *in each case*, that "The decision of the court of appeals is correct and does not conflict with any decision of this Court or any other court of appeals. Further review is therefore not warranted." *Coady* opposition brief, 2000 WL 34000205, at *4; *Benci-Woodward* opposition brief, 2000 WL 34000856 at *5; *Hukkanen-Campbell* opposition brief, *supra; see also Sinyard* opposition brief, 2002 WL 32135079, at *5 (stating same).

The Commissioner's opposition brief in *Benci-Woodward* is instructive. In *Benci-Woodward*, the Ninth Circuit held that, chiefly because it determined that California's attorney lien law does not convey to an attorney any ownership interest in his or her client's lawsuit, the attorney contingent fee portion of a punitive damages recovery is taxable to the client. 219 F.3d at 943. In opposing certiorari in *Benci-Woodward*, the Commissioner represented to this Court that neither *Estate of Clarks* nor *Srivastava*—cases expressly relied on by the court of appeals in this case—were in direct conflict with *Benci-Woodward*. *Benci-Woodward* brief in opposition, 2000 WL 34000856, at **6-7 (discussing *Estate of Clarks* and *Srivastava* and concluding that "The decisions cited by petitioners thus do not directly conflict with the decision in this case"). The Commissioner, in his



*Benci-Woodward* opposition, carefully explained for this Court why the *Benci-Woodward* decision did not "directly conflict" (2000 WL 34000856, at *7) with the Fifth Circuit's decision in *Srivastava*:

> The Fifth Circuit did not determine precisely what rights the plaintiff had transferred to his attorney in *Srivastava*; the court did, however, note its view that, under Texas law, the "attorney retainer agreements accompanied by contingent fee provisions assign more than just the fruit" even though they may have divested the taxpayers of "something less than the entire tree."

2000 WL 34000856, at *7 n.4 (quoting *Srivastava*, 220 F.3d at 360).

Similarly, the court of appeals in this case, after "find[ing] persuasive the reasoning of the Fifth Circuit" in *Srivastava* (Pet. App. 23a), employed the same fruit-and-tree metaphor to explain that, whatever the precise intricacies of an attorney's bundle of rights under California law, as a practical matter, "By signing the contingency fee agreement, [Mr. Banks] transferred some of the trees from the orchard, rather than simply transferring some of the orchard's fruit." Pet. App. 25a (citing *Estate of Clarks*, 202 F.3d at 358).

In addition, the *Benci-Woodward* court, unlike the court of appeals below, and unlike the courts of appeals in *Estate of Clarks* and *Srivastava*, did not analyze whether the anticipatory assignment of income doctrine applies to an attorney contingent fee contract. Thus, by the Commissioner's own reasoning in his *Benci-Woodward* opposition, the decision of the court of appeals below no more conflicts with *Benci-Woodward* than does *Estate of Clarks* or *Srivastava*. At best, any conflict between the decision of the court of appeals below and *Benci-Woodward* is over the practical significance of California's

attorney lien law. But such a shallow, recent, and narrow conflict does not merit review by this Court.

2. a. Contrary to the Commissioner's conclusory assertion that the decision of the court of appeals below "fails to apply elementary tax principles" (Pet. 8), the court of appeals correctly determined that the attorney's contingent fee portion of a recovery is not income to the taxpayer-client.

The court of appeals carefully and correctly explained why an attorney contingent fee contract should be contrasted with the classic intra-family anticipatory assignment of income cases such as *Lucas v. Earl* and *Helvering v. Horst*, *supra*. In *Lucas* and in *Horst*, this Court rejected the taxpayers' attempts to escape the bite of the progressive marginal tax rate by splitting or donating earned income with family members. As Justice Holmes, writing for this Court in *Lucas*, explained, "no distinction can be made according to the arrangement by which fruits are attributed to a different tree on which they grew." 281 U.S. at 115.

The court of appeals below, however, explained that, based on the reasoning of its previous decision in *Estate of Clarks*, the anticipatory assignment of income doctrine does not apply to a contingent fee contract between an attorney and his or her client, which is an arm's length transaction not involving a tax avoidance motive. Pet. 22a. Further, the court of appeals explained that the anticipatory assignment of income doctrine also does not apply where—unlike *Lucas* and *Horst*—the income assigned is speculative and unaccrued at the time of transfer, and contingent upon the efforts and personal skill of the assignee. Pet. App. 22a. As the court of appeals explained in its previous decision in *Estate of Clarks*:



> In *Lucas* and *Horst*, the income assigned to the assignee was already earned, vested and relatively certain to be paid to the assignor. It was a gift of accrued income to a family member. The assignor's purpose was to split income with a family member and avoid the donor's higher rate under the progressive income tax. The income had a tangible known value to the assignor. The assignee performed no services in order to receive the income. There was no business purpose other than tax avoidance. There was no joint venture to reduce a speculative claim to money. Not so in this case. Here there was no res, no fund, no proceeds, no vested interest, only a hope to receive money from the lawyer's efforts and the client's right, a right yet to be determined by judge and jury.

202 F.3d at 857. Employing Justice Holmes's metaphor in *Lucas* of the fruit-and-tree, the *Estate of Clarks* court explained further:

> The present transaction under scrutiny is more like a division of property than an assignment of income. Here the client as assignor has transferred some of the trees in his orchard, not merely the fruit from the trees. The lawyer has become a tenant in common of the orchard owner and must cultivate and care for and harvest the fruit of the entire tract. Here the lawyer's income is the result of his own personal skill and judgment, not the skill or largess of a family member who wants to split his income to avoid taxation.

*Id.* at 857-58.

b. In addition, "elementary tax principles" (Pet. 8) dictate that a litigant like Mr. Banks lacks the requisite control to be charged with income on the amount of lawsuit proceeds paid to his attorney as a contingent fee. This Court has established that unfettered control is the hallmark of income:

> It is not enough to trace income to the property which is its true source, a matter which may become more metaphysical than legal. Nor is the tax problem with which we are concerned necessarily answered by the fact that such property, if it can be properly identified, has been assigned. The crucial question remains whether the assignor retains sufficient power and control over the assigned property or over receipt of the income to make it reasonable to treat him as the recipient of the income for tax purposes.

*Commissioner v. Sunnen*, 331 U.S. 591, 604 (1948). The contingent fee contract Mr. Banks entered into operated to shift practical control of the contingent fee portion of the settlement proceeds from Mr. Banks to his attorney. Mr. Banks did not have uncontrolled discretion over the portion of the settlement proceeds rightfully retained by his attorney; he had no right to divest his attorney of the portion of the settlement paid to his attorney as a contingent fee. Accordingly, that portion of the settlement proceeds cannot be income to Mr. Banks.

3. The Court should deny the Commissioner's petition for certiorari because pending Congressional legislation, if enacted, would effectively moot the issue upon which the Commissioner seeks certiorari in future cases presenting the same question.

The proposed "Civil Rights Tax Relief Act of 2003," H.R. 1155 and S. 557, 108th Congress (2003), would, if enacted, amend the Internal Revenue Code to exclude from gross income "amounts received by a claimant (whether by suit or agreement and whether as lump sums or periodic payments) on account of unlawful discrimination." Under the proposed legislation, although backpay and frontpay would be taxed as if earned over the period of years to which the recovery relates, attorneys' fees recovered from discrimination defendants would be excluded under the provision quoted above.



The House bill was introduced on March 6, 2003 by a bipartisan coalition of legislators, and is currently pending in the House Committee on Ways and Means. The parallel Senate bill was proposed the same day and referred to the Senate Finance Committee. Senator Charles Grassley, the Chairman of the Senate Finance Committee, has recently stated that he favors the passage of the proposed legislation or its equivalent:

> "It remains a high priority for me that we end this terrible policy where individuals are subject basically to double taxation when they receive a settlement payment," Sen. Grassley said in an e-mail. "We passed legislation in the Senate last year to address this, and I hope we can get the bill to the president's desk this year."

Tom Herman, *How You Can Lose by Winning a Suit*, WALL ST. JOURNAL, Feb. 12, 2004, at D2.

It should be noted that although the proposed legislation would, if enacted, effectively moot the issue upon which the Commissioner seeks certiorari, nothing in the Internal Revenue Code, *as currently in effect*, expressly provides that a discrimination claimant must include in his or her gross income the attorney's contingent fee portion of a recovery. In circular fashion, section 61(a) of the Internal Revenue Code defines gross income as "all income from whatever source derived." This Court developed the anticipatory income doctrine as a *judicial* doctrine in *Lucas* and *Horst* to determine what constitutes "income" for purposes of section 61(a). With great care and in great detail, the court of appeals below explained why the anticipatory of assignment of income doctrine does *not* apply to an attorney contingent fee contract. Pet. App. 18a-25a. Thus, the fact that there exists in Congress proposed legislation that would moot this issue should not raise the inference that the Internal Revenue Code, *as currently in effect*, mandates the result

the Commissioner now seeks. Rather, the proposed legislation would apply broadly to exclude from successful plaintiffs' gross incomes *all* non-backpay and non-frontpay portions of discrimination awards, including amounts paid by discrimination defendants to plaintiffs' attorneys.

## CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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